

This is a glossary of all tax terms used in this package.

glossary

Ability To Pay

A concept of tax fairness that people with different amounts of wealth or different amounts of income should pay tax at different rates. Wealth includes assets such as houses, cars, stocks, bonds, and savings accounts. Income includes wages, interest and dividends, or other payments.

Adjusted Gross Income

Total income reduced by certain deductions such as for an IRA or student loan interest.

Benefits Received

A concept of tax fairness that people should pay taxes in proportion to the benefits they receive from government goods and services.

Business Taxes

Taxes levied on businesses by federal, state, or local governments. These include (in addition to corporate income taxes on earnings and profits), unemployment insurance, worker's compensation, contributions to social security, and Medicare insurance.

Credits

A direct reduction of tax owed. Credits are allowed for such purposes as child care, higher education costs, qualifying children, and the earned income credit for low-income taxpayers.

Dependent

A person who relies on someone else for support. A taxpayer may claim an exemption for a dependent if certain conditions (dependency tests) are met. Taxpayers cannot claim themselves or their spouses as dependents.

Direct Tax

A tax that cannot be shifted to others such as the federal income tax.

Dividends

A corporation's distributions to its shareholders from its earnings and profits.

Earned Income

Includes wages, salaries, tips, and net earnings from self-employment and other income received for personal services.

Earned Income Credit

A credit that can be paid to low-income workers, even if no income tax was withheld from the worker's pay. To receive the credit, a taxpayer must file a tax return.

E-file

Filing a return by computer. The information is transmitted over telephone lines to an IRS computer where it is automatically checks and processed. Refunds can go into the taxpayer's savings or checking account by Direct Deposit.

Excise Taxes

Taxes on the sale or use of specific products or transactions.

Exempt (from withholding)

Free from withholding of federal income tax. Must meet certain income, tax liability, and dependency criteria. Does not exempt a person from other kinds of tax withholding such as social security tax.

Exemption (Personal or dependency)

Amount that taxpayers can claim for themselves, their spouses, and eligible dependents. The total is subtracted from adjusted gross income before tax is figured on the remaining income.

Federal/State e-file

Program, sponsored by IRS in partnership with participating states, that allows the taxpayers to file federal and state income tax returns electronically at the same time.

File a return

To mail or otherwise transmit to an IRS service center the taxpayer's information, in specified format, about income and tax liability. This information – the return – can be filed on paper, electronically (e-file), or by telephone (TeleFile).

Filing Status

Based on a taxpayer's marital status and other factors. Determines the tax bracket and rate at which income is taxed.

Form W-4 (Employee's Withholding Allowance Certificate)

A form that helps an employer determine how much to withhold from an employee's paycheck for federal income tax purposes.

Formal Tax Legislation Process

The strict constitutional steps (involving Congress and the president) that a proposed tax must pass through before it becomes law.

Gross Income

Money, goods, and property you received that must generally be reported on a tax return and may be included in taxable income.

Horizontal Equity

The concept that people in the same income group should be taxed at the same rate. "Equals should be taxed equally."

Income Taxes

Taxes on income, both earned (salaries, wages, tips, commissions) and unearned (interest, dividends). Income taxes can be levied both on individuals (personal income tax) and businesses (business and corporate income taxes).

Indirect Tax

A tax that can be shifted to others, such as business property taxes. indirect taxes.

Informal Tax Legislation Process

Individuals and interest groups expressing and promoting their opinions about tax legislation.

Interest Income

Income a person receives from certain bank accounts or from lending money to someone else.

Individual Retirement Arrangement (IRA)

Any of several specific kinds of savings arrangements that also offer special tax advantages.

Payroll Taxes

Taxes collected from employers and employees to finance specific programs; levied on earned income, such as wages, salaries, and self-employment earnings.

(continued from front)

Personal Income Tax

A tax based on the amount of taxable income that people receive annually. Taxable income is less than total income because of exemptions and deductions.

Progressive Tax

A tax that takes a larger percentage of income from high-income groups than from low-income groups.

Property Taxes

Taxes on property, especially real estate, but can also boats, automobiles (often paid along with license fees), recreational vehicles, and business inventories.

Proportional Tax (Flat Tax)

A tax that takes the same percentage of income from all income groups.

Public Goods and Services

A benefit that cannot be withheld from those who don't pay for it and that may be "consumed" by one person without reducing the amount of the product available for others. Examples include national defense, street lights, and roads and highways. Public services include welfare programs, law enforcement, monitoring and regulating trade and the economy, and education.

Redevelopment or Enterprise Zone

A government-designated area (usually in a city) that is declared in need of restoration and revitalization. To encourage restoration, tax reductions may be available.

Regressive Tax

A tax that takes a larger percentage of income from low-income groups than high-income groups.

Sales Taxes

Taxes on retail products, based on a set percentage of retail cost.

Schedule

A form on which taxpayers report details about an item, usually income or expenses, summarized on the general return form.

Standard Deduction

An amount, provided by law and based on filing status, age, blindness, and dependency that taxpayers can deduct from their adjusted gross income before tax is determined.

Tariff Duty (Customs Duty or Import Duty)

Taxes on products imported from foreign countries.

Tax Credits

Amounts that can be deducted directly from taxes owed.

Tax Deductions

A part of a person's or a business's total expenditures that can be subtracted in determining taxable income.

Tax Exemptions

A part of a person's total income on which no tax is imposed.

Tax Liability (or total tax bill)

The amount of tax that must be paid. Taxpayers meet (or pay) their federal income tax liability through withholding, estimated tax payments, and payments made with the tax forms they file with the government.

Tax Shift

The process that occurs when a tax that has been levied on one person or group is in fact paid by others.

Tax Withholding

Money that an employer holds back from an employee's pay that is used to pay part or all of the employee's taxes.

Taxable Income

The income on which tax is figured.

Taxes

Required payments of money to governments that are used to provide public goods and services for the benefit of the community as a whole.

TeleFile

Filing returns over a touch-tone phone. The taxpayer must receive a TeleFile package by mail and qualify to use Form 1040EZ.

Transaction Taxes

Taxes on economic transactions, such as the sale of goods and services. These can be based on a set percentage of the sales value (ad valorem-sales taxes) or they can be a set amount on physical quantities ("per unit"-gasoline taxes).

Unearned Income

Income other than pay for work performed. Interest and dividends from savings or investments are common kinds of unearned income.

Vertical Equity

The concept that people in different income groups should pay different rates of taxes, or different percentages of their income as taxes. "Unequals should be taxed unequally."

Voluntary Compliance

A system of compliance that relies on individual citizens to report their income freely and voluntarily, calculate their tax liability correctly, and file a tax return on time.

Withholding ("Pay-as-you-go" taxation)

Money, for example, that employers withhold from employees' paychecks. This money is deposited for the government. (It will be credited against the employees' tax liability when they file their returns.) Employers withhold money for federal income taxes, federal social security taxes, and state and local income taxes in some states and localities.

Withholding Allowance

Claimed by an employee on Form W-4. An employer uses the number of allowances claimed, together with income earned and marital status, to determine how much income tax to withhold from wages.

1040PC

A condensed paper tax return prepared on a personal computer using IRS-accepted tax preparation software, plain paper, and a printer. The return is mailed to the IRS. Refunds go into a savings or checking account, by Direct Deposit.